USTELECOM
UNITED STATES TELECOM ASSOCIATION

NOTICE OF WRITTEN *EX PARTE* PRESENTATION

March 13, 2006

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Room TW-A325
Washington, D.C. 20554

Re: Jurisdictional Separations and Referral to the Federal-State Joint Board, CC Docket No. 80-286; Federal State Joint Board on Universal Service, CC Docket No. 96-45

Dear Ms. Dortch:

In accordance with section 1.1206(b)(2) of the Commission's rules, this letter and the attached ex parte memorandum are being filed electronically with your office. Please feel free to contact me if you have any questions.

Sincerely,

James W. Olson
Vice President Law and General Counsel

Ian Dillner, Office of the Chairman
Dana Shaffer, Office of Commissioner Tate, Federal Chair Separations Joint Board
Jessica Rosenworcel, Office of Commissioner Copps
Scott Bergmann, Office of Commissioner Adelstein
Tom Navin, Wireline Competition Bureau Chief
Sam Feder, General Counsel

USTELECOM MEMORANDUM IN RESPONSE TO NARUC FEBRUARY 28, 2006 LETTER

This memorandum responds to a letter from the National Association of Regulatory Utility Commissioners (NARUC), regarding an extension of the separations freeze.[1] US Telecom submitted a *White Paper* in December 2005 urging the Commission to preserve the status quo by extending the freeze on an interim basis while it conducts a rulemaking aimed at comprehensive separations reform.[2] As US Telecom explained, the Commission has authority to take such interim action without first seeking public comment or again referring the matter to the Joint Board and, given the imminence of the scheduled expiration and the tremendous (and unnecessary) work that would be required if the freeze were permitted to lapse, such a freeze should be adopted without delay.

NARUC does not oppose an extension of the freeze, but questions the legality of the Commission adopting an interim freeze without first conducting a notice-and-comment rulemaking coupled with a referral to the Joint Board. As explained below, NARUC is wrong on the law. The Commission can and should promptly extend the freeze on an interim basis in conjunction with a Notice of Proposed Rulemaking seeking comment on the procedural and substantive issues associated with fundamental separations reform, as recommended in the *White Paper*.

1. The Commission May Extend the Freeze on an Interim Basis Without Seeking Public Comment.

The Administrative Procedures Act authorizes an agency to forego notice and comment rulemaking when it "for good cause finds … that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b)(3)(B). The leading case interpreting this provision, *Mid-Tex Electric Cooperative, Inc. v. Federal Energy Regulatory Commission*, 822 F.2d 1123 (D.C. Cir. 1987), makes it clear that, in circumstances such as these, the Commission may dispense with public notice and comment if it adopts an interim extension of the separations freeze in accordance with US Telecom's proposed procedure.

In *Mid-Tex*, the D.C. Circuit upheld an interim FERC rule governing inclusion in the rate base of plant under construction. The interim rule was substantively identical to an earlier rule, which the court had vacated and remanded to give FERC an opportunity to supply a more detailed explanation and address concerns about the rule's potential effects on competition. In finding that FERC had demonstrated "good cause" for adopting the interim rule without notice and comment, the court relied on several factors, each of which applies in the context of the interim separations freeze requested by US Telecom.

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[1] Letter from James Bradford Ramsey, General Counsel, NARUC to Marlene H. Dortch, Secretary, FCC, *ex parte* presentation in CC Docket Nos. 80-286 and 96-45, dated Feb. 28, 2006 ("*NARUC Ex Parte*").

[2] *See* United States Telecom Association, *Paving the Way for Jurisdictional Separations Reform*, dated Dec. 12, 2005 ("*White Paper*").

First, the D.C. Circuit explained that the "interim status of the challenged rule is a significant factor in our determination" and emphasized that "we have consistently recognized that a rule's temporally limited scope is among the key considerations in evaluating an agency's 'good cause' claim." *Id.* at 1132. Importantly, the court did not hold that an agency must set a firm deadline for expiration of the interim rule in order to avail itself of the good cause exception. To the contrary, the agency need only "convince us … that it is not engaging in dilatory tactics during the interim period." *Id.* By heeding US Telecom's suggestion that the Commission adopt a Notice of Proposed Rulemaking in conjunction with the interim extension of the freeze, and making plain its intent to act expeditiously, the Commission can easily satisfy this aspect of *Mid-Tex*.[3]

Second, the court credited FERC's explanation that the fundamental approach of the interim rule was "'supported by a broad and substantial record'" and had been approved in large part by the court upon review of the original rule. *Id.* at 1131, 1133. Here, the existing separations freeze received broad support not just from the Separations Joint Board, but from virtually every corner of the industry. Indeed, there was such widespread support that, in contrast to most significant FCC policy decisions, not a single entity sought judicial review. And, as the *White Paper* explains, the factors underlying the freeze – a desire to reduce regulatory burdens during the transition from regulated monopolies to a deregulated, competitive environment and a recognition that separations methodologies make little sense in an increasingly packet-switched network – "are even more pressing today." *White Paper* at 2-5. In fact, the always-arbitrary nature of jurisdictional cost allocations has been exacerbated by the growing prevalence of distance- and usage-insensitive services, which do not fall into neat jurisdictional buckets. As the Commission recently observed, "as more services are offered over a single loop, cost allocations are likely to become more arbitrary and thus less reasonable." *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14928 n.434 (2005).

Third, in *Mid-Tex*, the court of appeals found convincing FERC's concerns regarding regulatory confusion and irremedial financial consequences if the agency had failed to act, explaining that the rule FERC extended on an interim basis sought to "foster more efficient and rational *long-range* capital investment decisions" and that the original rule had been relied on by the industry for more than two years as a "'regulatory framework within which utilities can make an unbiased assessment of the need for new capacity and of the best means of meeting that end.'" *Mid-Tex*, 822 F.2d at 1133, 1134 (emphasis in original). This rationale applies equally well to the separations freeze. The industry has relied on the freeze for almost five years, a time period which has witnessed unprecedented investment in new broadband technologies and services.

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[3] The Commission, of course, enjoys great discretion to adopt interim rules pending longer-term reform of its regulations, particularly where, as here, the interim rules "maintain that status quo so that the objectives of a pending rulemaking proceeding will not be frustrated." *MCI Telecoms. Corp. v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984); *see also CompTel v. FCC*, 117 F.3d 1068 (8th Cir. 1997); *Federal Land Bank of Springfield v. Farm Credit Admin.*, 767 F. Supp. 1239, 1249 (D. Me. 1987) (collecting cases demonstrating that "[i]nterim rules have been allowed to stand, despite procedural deficiencies, principally to preserve the status quo or to prevent injury to those challenging the regulations until the agency can issue procedurally valid permanent regulations.").

Turning back the clock now – as would occur if the freeze were not extended – would jeopardize the economic basis for that recent investment and seriously chill future investment, at the very time when many ILECs are transforming their networks into all-service broadband platforms.

The industry has relied on the freeze in another respect as well: Over the five years the freeze has been in place, the personnel responsible for compliance with the old rules have been reassigned or have retired, and the relevant back-office systems have not been maintained. The old rules required hundreds of separate studies, and one carrier alone devoted at least 60 employees and 11 major computer systems to maintaining the separations data bases and performing separations calculations. *White Paper* at 1-2. That infrastructure cannot be resurrected on short notice, making it imperative that the Commission extend the freeze as quickly as possible.

NARUC's efforts to distinguish *Mid-Tex* are in vain. It argues, first, that *Mid-Tex* is inapplicable because the FERC's interim rule "was a response to a court reversal of the underlying rule," while the FCC "has no comparable judicial, legislative or executive mandate." *NARUC Ex Parte* at 3. The Commission, however, should not be put in a worse position because its original rule was lawful: FERC's interim rule responded to a judicial mandate because FERC's original rule was challenged successfully on appeal; by contrast, the separations freeze was widely supported and no one took the Commission to court. Furthermore, while NARUC asserts that the exigency here is of the Commission's own making, the Commission has had a more-than-full plate on the telecom side for the past five years, dealing with such important, resource-intensive, and interrelated matters as unbundling (including court remands), universal service (including court remands), IP-enabled services, and intercarrier compensation. It was entirely reasonable for the Commission not to address extension of the freeze before giving those matters full consideration. Now, however, an urgent situation exists with respect to the upcoming expiration of the freeze, and it is necessary and appropriate for the Commission to take timely interim action to avoid tremendous disruption to the industry.[4]

[4] In the same vein, NARUC cites cases holding that the good cause standard provides relief only in "emergency situations." Such a situation plainly exists here given the imminent expiration of the freeze and the massive waste of resources that would occur absent an interim extension. The cases cited by NARUC are not to the contrary. In *Thrift Depositors of America v. Office of Thrift Supervision*, 862 F. Supp. 586 (D.D.C. 1994), the district court rejected OTS's contention that it had good cause to dispense with public comment before adopting an "Interim Final Rule" regarding the geographic identity of stockholders in thrifts converting from associations to stock companies because (1) OTS's own actions in granting waivers to entities seeking to convert undermined its argument that there was an emergency precluding public comment before adoption of a rule, and (2) "even the OTS does not know when a final rule will likely be promulgated." *Id.* at 592-93. Here, the existence of an urgent situation warranting immediate action is established by US Telecom's *White Paper*, and US Telecom urges the Commission to move expeditiously in an ensuing notice-and-comment rulemaking. *American Federation of Government Employees v. Block*, 655 F.3d 1153 (D.C. Cir. 1981), involved an interim USDA regulation on poultry inspections that was adopted without public comment and then affirmed by the court; the court only rejected USDA's effort to treat that interim regulation as permanent without undertaking a rulemaking. The court accordingly ordered USDA to "institute rulemaking proceedings forthwith." *Id.* at 337. By initiating a rulemaking to address

NARUC next contends that FERC's interim rule was of "short duration," while US Telecom does not propose a definitive end to the interim extension. *NARUC Ex Parte* at 3. FERC, however, did just what US Telecom recommends here: it adopted an interim rule pending conclusion of a further rulemaking proceeding, while taking steps to assure the court that it would act with appropriate speed. *Mid-Tex*, 822 F.2d at 1132 & n.43 (referencing an internal scheduling document showing an anticipated date for adopting a permanent rule). By adopting an NPRM in conjunction with the freeze and demonstrating its intent to move with appropriate dispatch toward final action, the Commission can provide assurance that the extension truly will be interim.

NARUC also argues that, while FERC took steps to protect customers from injury, extension of the freeze without notice and comment could produce increases in intrastate rates if there were "any imbalance against states." *NARUC Ex Parte* at 3. NARUC suggests no basis for this concern, and there is none. Preserving the status quo will not suddenly open the door to rate hikes. In fact, local phone rates have declined in both real (inflation-adjusted) and absolute terms since the freeze was instituted; between 2001 and 2004, the consumer price index for all items increased from 100 to 109.2 (using 2000 as a base year) while the consumer price index for local residential telephone service decreased from 100 to 96.3.[5] Moreover, local rates are disciplined by the market,[6] so separations rules serve no continuing purpose in assuring reasonable rates. Providing a further, albeit unnecessary, backstop, state rate regulation is more than up to the task of preventing unjustified rate increases. The vast majority of states use some form of incentive-based regulation in which costs have little if any relevance, and even those few states still employing rate base regulation aggressively scrutinize proposed rate increases.

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longer-term separations reform, as US Telecom has urged, the Commission can easily avoid the problem encountered by USDA.

[5] These figures are derived from the 2004/2005 edition of the *Statistics of Communications Common Carriers*, Table 5.10.

[6] *See e.g., Verizon Communications Inc. and MCI Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-75, FCC 05-184, at ¶¶ 3, 91 (rel. Nov. 17, 2005) (noting "the rapid growth of intermodal competitors – particularly cable telephony providers (whether circuit-switched or voice over IP (VoIP) – as an increasingly significant competitive force in [the mass] market," anticipating "that such competitors likely will play an increasingly important role with respect to future mass market competition," and explaining that "the record reveals that growing numbers of subscribers in particular segments of the mass market are choosing mobile wireless service in lieu of wireline local services"); Marguerite Reardon, *Verizon Plays Hardball on Pricing*, New.com, Nov. 9, 2005, available at http://new.com.com/Verizon+plays+hardball+on+pricing/2100-1037_3-5942158.html, ("Verizon Communications has reduced rates on its traditional telephony service to new lows as it tries to compete with cable companies who are now offering telephony as part of their own packages."); *see also* Viktor Shvets & Andrew Kieley, Deutsche Bank, *Consumer Wireline Erosion: The Strategic Response to "Water Torture"* at 2 (May 19, 2005) ("access line losses will escalate over the next 12 months towards 6%, and possibly as high as 8% per annum, driven by wireless cannibalization, rapid take-off of cable telephony, and proliferation of non-facilities-based VoIP services.").

NARUC's final two arguments fare no better. First, it asserts without explanation that the freeze rule would be "of broad effect" and that courts have held that, the more expansive the reach of an agency's rules, the greater the necessity for public comment. *NARUC Ex Parte* at 3. The interim rule simply maintains the status quo, however, consistent with unrebuttable evidence that the reasons underlying the freeze are even stronger today than they were five years ago. The effect of an interim extension would be *avoidance* of the dire adverse effects of allowing the current freeze to expire. Relatedly, NARUC claims that, while FERC's rule was "a bridge" between a rule in which the court had found minor defects and a future rule that the court anticipated would be generally similar, "there is no reason to believe that a permanent freeze is desirable or even legally permissible." *Id.* at 4. The interim extension likewise would serve as a bridge to fundamental separations reform – whether such reform amounts to a permanent freeze, elimination of the separations rules, or something else. Whether a permanent freeze is desirable or legally permissible is not at issue here; that will be the subject for the rulemaking the Commission initiates along with the interim extension.[7]

Finally, it is difficult to comprehend NARUC's suggestion that harm would result from an interim extension of the freeze, inasmuch as NARUC does not challenge the extension of the freeze itself, but only proposes that the Commission must first take procedural measures – a Notice of Proposed Rulemaking and a referral to the Joint Board – that the Commission can in fact take *while* the interim freeze in effect. By contrast, the harms that would result without the freeze, or that would result from the delay inherent in NARUC's proposed process, are undisputed. If the Commission were to postpone implementing any freeze until after it issued a Notice of Proposed Rulemaking, analyzed comments and reply comments, and awaited the outcome of referral to the Joint Board, this would only extend the uncertainty about whether the Commission ultimately would extend the freeze, which would force carriers to begin preparing to reinstitute burdensome and resource-intensive separations studies, or face potential non-compliance with Commission rules if they wait. *See White Paper* at 1.

2. The Commission Need Not Refer the Interim Extension to the Joint Board.

NARUC concedes that, if no rulemaking notice is required, no referral to the Joint Board is necessary. Section 410(c) expressly provides as much: "The Commission shall refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations, *which it institutes pursuant to a notice of proposed rulemaking* …." 47 U.S.C. § 410(c) (emphasis added). Nonetheless, based on its erroneous conclusion that the Commission must employ notice and comment procedures, NARUC asserts that the Commission cannot act without a referral. *NARUC Ex Parte* at 4. As explained above,

[7] NARUC erroneously suggests that if the FCC adopts an interim extension of the freeze without engaging in a rulemaking, states would have to "choose between complying with the order and complying with the rules," raising the possibility that "carriers might recover more or less than 100 percent of their costs." *Ex Parte* at 2. However, this argument is merely an indirect way of reiterating NARUC's basic, flawed contention that the Commission must seek public comment before changing its rules. In reality, there would be no tension between the rules and the extension order because the extension order would change the rules by eliminating the current expiration date. And in any event, there is no risk that carriers would over- or under-recover their costs because, as noted above, local exchange prices are competitively disciplined.

NARUC's predicate is wrong: the Commission has the requisite "good cause" to proceed without issuing an NPRM and therefore it may likewise adopt the interim extension without referring this matter to the Joint Board.

NARUC likewise is wrong in arguing that, even if a referral were needed, that requirement has not already been satisfied. *Id.* The Joint Board already considered the possibility of an indefinite freeze in response to the Commission's initial referral of separations issues, which asked State members of the Joint Board to "develop a report that would identify additional issues that should be addressed by the Commission in its comprehensive separations reform effort." *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, Notice of Proposed Rulemaking, 12 FCC Rcd 22120, ¶¶ 9-19 (1997). The Commission's decision to adopt a five-year freeze does not negate the fact that the Joint Board had the opportunity to assess the merits of an indefinite or longer-term freeze. Having already considered that possibility, no further referral is necessary. *See Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 416-17 (5th Cir. 1999) (if the Joint Board "had already considered the jurisdictional effects" of the Commission's decision in the initial referral to the Joint Board, such action "fulfills § 410(c)'s consultation requirement."). The referral requirement of Section 410(c) applies to "proceedings" that the Commission initiates through notice of proposed rulemaking, not separately to every particular proposal that the Commission eventually considers.

3. Conclusion

The Commission has no legal obligation to seek public comment or issue a referral to the Joint Board before adopting an interim extension of the separations freeze, coupled with a Notice of Proposed Rulemaking seeking comment on the procedural and substantive issues associated with